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AZ CORP COMMISSION
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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE – Chairman
BOB STUMP
BOB BURNS
TOM FORESE
ANDY TOBIN

Arizona Corporation Commission)
Investigation into Potential Improvements)
to its Water Policies)

Docket No. W-00000C-16-0151

NOTICE OF FILING

Insight Consulting hereby submits this Notice of Filing in the above-referenced matter. Attached are proposed Statements of Policy developed by a working group of water and wastewater utilities, and their representatives, for the Commission's consideration at the May 19, 2016 "Water Workshop" to be held in Phoenix, Arizona.

RESPECTFULLY SUBMITTED this 13th day of May, 2016.

By

Paul Walker
Insight Consulting
330 East Thomas Road
Phoenix, Arizona 85012

ORIGINAL and thirteen (13) copies
of the foregoing were filed
this 13th day of May, 2016, with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Arizona Corporation Commission

DOCKETED

MAY 13 2016

DOCKETED BY	
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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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Arizona Corporation Commission)
Investigation into Potential Improvements)
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Docket No. W-00000C-16-0151

Arizona Corporation Commission

Policy Statement on Rate Cases for Small Water and Wastewater Utilities

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under § 41-1033, Arizona Revised Statutes, for a review of the statement.

The rate case process can often be difficult and even intimidating for small water or wastewater utilities. Such utilities typically lack experience with the rate case process, and do not have professional regulatory accountants or rate experts on staff to prepare and file such cases, deal with discovery, work with Staff and bring the case to conclusion. If small utilities are

unable to prepare a rate case or complete the rate case process, their rates will become out-of-date due to inflation and other factors, affecting their financial viability as well as their ability to fund necessary maintenance and capital improvements—and leading to rate shock for customers when rates are finally increased.

Our rate case rule¹ recognizes that small companies are different by allowing smaller companies to file fewer schedules, and we have also allowed smaller companies to file a simplified “short form”. Further, our rate case time-clock rule² requires a faster process for smaller companies. We recently updated the utility classifications, which is another measure that should help smaller companies.³ Lastly, we worked with the Legislature to amend A.R.S. § 40-250 to remove the hearing requirement for utilities with intrastate gross operating revenues of less than one million dollars.⁴ Still, many small company rate cases can, when issues are contested, become lengthy and extend well beyond specified processing timelines.

Today, we take further measures to reduce the burdens of rate cases on smaller utilities. Accordingly, we adopt the attached policy statement to streamline the rate case process and reduce the burden on small water and wastewater companies.

ORDER

IT IS THEREFORE ORDERED that the Commission adopts this substantive policy statement in accordance with A.R.S. § 41-1091.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall cause the attached policy statement to be posted on the Commission’s website in accordance with A.R.S. § 41-1091.01 and that they cause the policy statement (or a summary

¹ A.A.C. R14-2-103.

² A.A.C. R14-2-103(B)(11).

³ See Notice of Final Rulemaking at 20 Arizona Administrative Register 3439 to 3445.

⁴ Arizona Laws 2015, Ch. 178, § 1 (S.B. 1098). Previously, utilities with revenues under \$250,000 were exempt.

thereof) to be published in the Arizona Administrative Register in accordance with A.R.S. §§ 41-1091(A) and 41-1013(B)(15).

Policy Statement on Small Water Utility Rate Cases

1. We recognize that adopting inverted block tiered rates can lead to reduced water use by customers—indeed, that is the point of this conservation-focused rate design. However, the reduced water use will reduce the revenues of the water utility. When a class C, D, or E water utility is transitioned from a single volumetric rate (or a flat monthly rate or non-inverted tiered rates, if any utilities remain on those rate designs) to an inverted block tiered rate design, the conservation adjustment should be larger than the conservation adjustments we allow for larger utilities, to ensure that reduction in use caused by the new rates does not hinder the utility from earning its revenue requirement.
2. We encourage public participation in rate cases, and recognize that value and perspectives that intervenors bring to rate cases. However, multiple intervenors can be a burden for Class C, D and E water or wastewater utilities. Accordingly, we encourage the Hearing Division to use the class spokesman procedure in A.A.C. R14-3-105(C) in appropriate cases to ensure that intervenors do not unduly prolong the process. In addition, as with all discovery, intervenor discovery should not be unreasonable or disproportionate to the amounts at stake.
3. A Class C, D, and E water or wastewater utility that faces a water supply emergency (such as a failed well, pump, or tank) may request an emergency surcharge. The emergency surcharge procedure will comply with all legal requirements for an “emergency rate case”. The emergency surcharge shall be based on the estimated costs of repairs or replacement plant. The emergency surcharge shall be based on a ten-year amortization based on the interest rate for any loan anticipated to fund the repairs or replacement plant, or on the cost of debt approved in the most recent “Class A” water utility rate case.

4. Class C, D, and E water or wastewater utilities face significantly increased business risk as compared to larger water and wastewater utilities. It is the policy of this Commission to recognize this increased business risk. We have separately established a process to review the ROE processes in California and Florida for possible adoption in Arizona. We direct that this process should include investigation of business risk for small utilities including consideration of establishing minimum operating margins and the use of ROE adders for Class C, D and E water or wastewater utilities, to recognize increased business risk and that these firms are not able to raise capital on the same terms as the much larger companies included in the proxy groups for determining cost of equity.
6. Revenue requirements for Class C, D and E water or wastewater utilities should be based on the greater of the rate of return method or the operating margin method.
7. We have sometimes approved purchased power adjustors and purchased water adjustors for larger water companies. We will consider requests for such adjustors from smaller utilities as well—there is no minimum utility size required for adjustor mechanisms.
8. In rate cases for Class D or E water or wastewater utilities, we will consider establishing a fixed surcharge to fund a “system improvement” fund and/or an “emergency repair and replacement” fund. Such requests will be considered on a case-by-case basis. Surcharges will be capped, and funds from each surcharge must be strictly tracked and spent only for the specified purposes. We may require surcharge funds be deposited into separate, segregated bank accounts. Any such surcharges will continue until the utility’s next rate case. The surcharge amount will not change between rate cases.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE – Chairman

BOB STUMP

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Arizona Corporation Commission)
Investigation into Potential Improvements)
to its Water Policies

Docket No. W-00000C-16-0151

Policy Statement on Conservation Adjustments for Water Utilities

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under § 41-1033, Arizona Revised Statutes, for a review of the statement.

Arizona is located in the arid, dry southwestern United States where limited water resources are already overtaxed and becoming even more threatened. In addition to sharing regional challenges, Arizona's communities and public officials have struggled for decades with water supply challenges at state and local levels. The Central Arizona Project and the Arizona Groundwater Management Act are testaments to the state's unending battle to preserve access to clean, safe and reliable water for every Arizonan.

In recognition of these local and regional challenges, the Commission and the water utilities it regulates supported the shift to conservation-oriented rate designs nearly two decades ago. The use of increasing block rates has been effective in sending conservation-oriented price signals to customers and, as a result, water utility customers have reduced their water usage.

However, the shift to conservation-oriented rates for water utilities has also had unintended, adverse consequences. Some customers have experienced rate shock as a result of disproportionately large increases in their water bills. Additionally, many water utilities have experienced heightened seasonal revenue volatility and worse, significant revenue shortfalls.

Revenue erosion occurs when consumption is reduced due to the conservation signals, and exacerbated by rate designs that discount the cost of water at one end and attempt to recover too much revenue at higher levels of consumption. Although those at the higher levels of consumption do need a price signal the most, their conservation also has the greatest impact on the water utility's revenues. In the past, the Commission has been too slow to recognize these impacts.

There has been considerable disagreement amongst stakeholders, usually in rate cases, over how to address the revenue shortfalls experience by water utilities due to water conservation by their customers. Revenue shortfalls can be particularly problematic for small utilities that lack experience with the rate case process, and do not have professional regulatory accountants or rate experts on staff to prepare and file such cases. Now, based on the experience gained since the shift to conservation-oriented rate designs, the Commission can provide further guidance by adopting this "Policy Statement on Conservation Adjustments for Water Utilities."

The intent of this policy is to better assure that water utilities have an opportunity to collect the level of revenue authorized by the Commission in a rate case.

It is the policy of this Commission, in all pending and future proceedings, that rate decisions for water utilities shall -

1. Consider patterns of customer declining usage and expected additional water conservation driven by increases to rates and changes to the water utilities' rate design; and
2. Make an appropriate conservation adjustment to expected water sales used in establishing the rate design and level of rates for the water utility.

In order to achieve these objectives, conservation adjustments shall be subject to the following considerations -

1. One-time, fixed water conservation adjustments (e.g. fixed reduction in projected average per customer sales used for rate design purposes) are useful tools that are likely to improve a water utilities' opportunity to collect its authorized level of revenue. However, a one-time, fixed water conservation adjustment may still result in the under recovery of authorized revenue if declining usage is greater than projected.
2. A Water Rate Adjustment Mechanism (WRAM) that provides for a true-up of authorized revenues to collected revenues and adjusts rates prospectively to assure that a water utility has the opportunity to collect its authorized revenue, should be provided when requested by the water utility in its rate case.
3. When a water utility is transitioned from a single volumetric rate (or a flat monthly rate or non-increasing block rates) to an increasing block rate design, the conservation adjustment should be larger than the conservation adjustment we would

otherwise allow, to ensure that reduction in use caused by the new rates does not prevent the utility from earning its revenue requirement.

ORDER

IT IS THEREFORE ORDERED that the Commission adopts this substantive policy statement in accordance with A.R.S. § 41-1091.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall cause the attached policy statement to be posted on the Commission's website in accordance with A.R.S. § 41-1091.01 and that they cause the policy statement (or a summary thereof) to be published in the Arizona Administrative Register in accordance with A.R.S. §§ 41-1091(A) and 41-1013(B)(15).

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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Arizona Corporation Commission)
Investigation into Potential Improvements)
to its Water Policies)

Docket No. W-00000C-16-0151

Arizona Corporation Commission

Policy Statement on Rate Design for Water Utilities

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under § 41-1033, Arizona Revised Statutes, for a review of the statement.

Arizona is located in the arid, dry southwestern United States where limited water resources are already overtaxed and becoming even more threatened. In addition to sharing regional challenges, Arizona's communities and public officials have struggled for decades with water supply challenges at state and local levels. The Central Arizona Project and the Arizona Groundwater Management Act are testaments to the state's unending battle to preserve access to clean, safe and reliable water for every Arizonan.

In recognition of these local and regional challenges, the Commission and the water utilities it regulates supported the shift to conservation-oriented rate designs nearly two decades ago. The use of increasing block rates has been effective in sending conservation-oriented price signals to customers and, as a result, water utility customers have reduced their water usage. However, the shift to conservation-oriented rates for water utilities has also had unintended, adverse consequences. Some customers have experienced rate shock as a result of disproportionately large increases in their water bills. Additionally, many water utilities have experienced heightened seasonal revenue volatility and worse, significant revenue shortfalls. Revenue erosion occurs when consumption is reduced due to the conservation signals, and exacerbated by rate designs that discount the cost of water at one end and attempt to recover too much revenue at higher levels of consumption. Although those at the higher levels of consumption do need a price signal the most, their conservation also has the greatest impact on the water utility's revenues. In the past, the Commission has been too slow to recognize these impacts.

There has been considerable disagreement amongst stakeholders, usually in rate cases, over how to balance the multiple objectives underlying a conservation-oriented rate design. Now, based on the experience gained since the shift to conservation-oriented rate designs, the Commission can provide further guidance by adopting this "Policy Statement on Rate Design for Water Utilities." The intent of this policy is to promote the adoption of rate designs based on the balanced objectives of conservation, customer fairness, and revenue stability for water utilities through the standards and guidelines in this policy.

The importance of fulfilling each of these objectives cannot be understated. For that reason, it is the policy of this Commission, in all pending and future proceedings, that rate designs for water utilities shall –

1. Encourage conservation, including discouraging wasteful water use and promoting efficient uses of water.
2. Minimize customer impact by reducing or avoiding unexpected changes in customer bills.
3. Promote revenue stability through balanced rate designs that accurately reflect fixed versus variable costs in order to yield the authorized revenue in a stable and predictable manner.

In order to achieve these objectives, water utility rate designs shall be subject to the following considerations -

1. The preferred water utility rate design will be a three-tier increasing block rate design with a non-discretionary usage tier (Rate Tier 1) applicable only to residential customers. Additional rate tiers and other rate design elements may be appropriate for large companies with large customer bases where appropriate analysis and justification is provided.
2. Large commercial or industrial customers, large master-metered customers or large standpipe customers should be considered separately from the general rate design for typical residential and other commercial users.

3. Significant changes in rate design for a single water utility may require several rate cycles before applicable targets are reached. Gradualism should guide these transitions in order reduce disproportionate customer-specific impacts, as well as stabilize the utility's revenue recovery.
4. Case specific departures from standard rate design requirements and revenue targets may be necessary to address special circumstances.

ORDER

IT IS THEREFORE ORDERED that the Commission adopts this substantive policy statement in accordance with A.R.S. § 41-1091.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall cause the attached policy statement to be posted on the Commission's website in accordance with A.R.S. § 41-1091.01 and that they cause the policy statement (or a summary thereof) to be published in the Arizona Administrative Register in accordance with A.R.S. §§ 41-1091(A) and 41-1013(B)(15).

Accordingly, in order to ensure that the goals of conservation and the rights of utilities to a reasonable opportunity to earn their authorized revenues are duly balanced, water utility rate designs shall utilize the following guidelines for (1) allocating revenue recovery between the base and variable commodity charges, and (2) allocated recovery of revenue between tiers:

Option 1

1. Base Charges – Not less than 45% of revenue
2. Top Tier – Not more than 25% of revenue
3. For Companies with existing three-tier rates, all tiers shall be increased at the same percentage

The Commission directs Commission Staff to initiate a rulemaking to adopt rules to implement this policy.

Option 2

1. Base Charge Plus 1st Tier = 50% to 70% of revenue
2. Base Charge – 45% to 55% of revenue
3. Bottom Tier – 5% to 25% of revenue
4. Top Tier – 10% to 20% of revenue

The Commission directs Commission Staff to initiate a rulemaking to adopt rules to implement this policy.

Option 3

1. Base Charges – 55% to 70% of revenue
2. Minimize “Below Cost” Revenue Tiers
3. Top Tier – Maximum of 10% of revenue

The Commission directs Commission Staff to initiate a rulemaking to adopt rules to implement this policy.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE – Chairman

BOB STUMP

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Arizona Corporation Commission)
Investigation into Potential Improvements)
to its Water Policies)

Docket No. W-00000C-16-0151

Arizona Corporation Commission

Policy Statement on Cost of Capital Reform

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under § 41-1033, Arizona Revised Statutes, for a review of the statement.

In his seminal work, Principles of Public Utility Rates, Professor James C. Bonbright wrote that, “today, the most critical and controversial part of a general rate case is likely to be given over to the conflicting testimony and exhibits of the finance witnesses for the different parties and, sometimes, for the commission or its staff.”¹ Much has changed in the world since Professor Bonbright published his book in 1961 – but nothing has changed with regard to the conflict and controversy surrounding finding “the fair rate of return” for investments in regulated utility companies.

¹ Principles of Public Utility Rates, 1961, Chapter XV, Paragraph 1

In the vast majority of water and wastewater rate cases, the Arizona Corporation Commission ("Commission") and the parties before it, engage in lengthy, costly, and repetitive testimony litigating the appropriate return on equity. Virtually all the testimony submitted by all parties, including Commission staff, relies at least in part on arguments based on the same financial models. The parties use different assumptions and inputs to those models, and then litigate extensively on which assumptions are "more valid."

All of that litigation increases the cost of each rate case – companies often hire expert witnesses, Commission staff, and the Residential Utility Consumers Office (RUCO) dedicate staff members and external consultants to draft testimony and respond in detail to the company's position. Hearings often spend days with parties cross-examining each other's cost of capital witness(es). In the end, the ratepayers are saddled with the costs the company incurs for lawyers, responses, testimony, and hearing time – and the Commission's staff, and RUCO, spend large portions of their time and limited budgets to litigating and re-litigating the cost of capital in dozens of water and wastewater cases each year.

Litigating the appropriate cost of capital for entities like water and wastewater utilities on a case-by-case and repetitive basis, is in and of itself inefficient. Other states, notably the Florida Public Service Commission, and the California Public Utilities Commission, have adopted a standard return on equity formula for all water and wastewater companies in their states for a given year. Water and wastewater companies in those states no longer have to litigate, at ratepayers' expense, the specific cost of capital for each utility in each rate case.

Given that the Commission is interested in both reducing the costs borne by ratepayers, and in making processes and staff resources more efficient, we hereby direct that representatives from the Commission, and from the water and wastewater industry shall be assigned to travel to Florida

and California for detailed briefings on how those states have streamlined this aspect of utility ratemaking. We invite RUCO to also designate staff to join in this fact-finding mission.

Within 90 days, we expect that task force to report back to us with a consensus recommendation on how the Arizona Corporation Commission can implement a standard return on equity model, taking the best practices from the Florida Public Service Commission and the California Public Utilities Commission and developing an appropriate, cost-saving, conflict reducing model for the Commission to implement.

The expected results from this effort will be: To reduce, dramatically, the rate case expense borne by ratepayers of water and wastewater utilities, and; To reduce, dramatically the burden on Commission staff, our Hearings Division, and RUCO in litigating cost of capital for water and wastewater companies.

We believe that the recommendation from this task force must include a model that provides stakeholders with an opportunity to both present evidence and to respond to evidence as the Commission develops a recommended cost of equity each year. We also recognize that some companies may wish to litigate for a different cost of equity based on the unique circumstances they face.

ORDER

IT IS THEREFORE ORDERED that the Commission adopts this substantive policy statement in accordance with A.R.S. § 41-1091.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall cause the attached policy statement to be posted on the Commission's website in accordance with A.R.S. § 41-1091.01 and that they cause the policy statement (or a summary thereof) to be

published in the Arizona Administrative Register in accordance with A.R.S. §§ 41-1091(A) and 41-1013(B)(15).

IT IS FURTHER ORDERED that representatives of the Commission, and representatives of the water and wastewater industry shall be directed to initiate a fact-finding mission, and to return to the Commission, within 90 days, a consensus recommendation for the Commission's consideration to achieve the expected results outlined above. The Commission invites the Residential Utility Consumers Office to also assign a representative to join in this effort.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE – Chairman
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Arizona Corporation Commission)	
Investigation into Potential Improvements)	Docket No. W-00000C-16-0151
to its Water Policies)	

Arizona Corporation Commission

Policy Statement on Consolidating the Arizona Water Industry

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under § 41-1033, Arizona Revised Statutes, for a review of the statement.

In 1998, the Commission launched a Task Force to investigate the state of the water industry, and to make recommendations to the Commission on ways to strengthen the industry so that it would be better able to meet financial and environmental challenges. The first goal

outlined by the Task Force was: "Reduce the number of small, non-viable water systems through new rules and procedures."¹

We note that in 1996, the State of Pennsylvania adopted a similar goal; (See, 52 Pa. Code § 69.711 and 69.721) The differences in results are stunning.

In Arizona we added new water companies over the past 18 years, meanwhile, Pennsylvania went from over 500 water companies, to under 100. The results of the consolidation in Pennsylvania were described by then-Chairman of the Pennsylvania Public Utilities Commission, Rob Powelson, thusly: "[Our] policy of encouraging regionalization and consolidation via inter-agency cooperation and acquisition incentives has resulted in improved water quality and service reliability for many customers throughout our state – customers who were previously faced with chronically non-compliant service from small, marginally viable providers."² By way of comparison, in the past 10 years, 18 Emergency Rate Cases have been filed by water and wastewater utilities in Arizona at the Arizona Corporation Commission.

We believe that the dramatic disparity in results is largely driven by the fact that Pennsylvania adopted a clear and transparent policy combined with objective incentives when it set out to consolidate the water industry; and Arizona did not. Instead, the Commission has relied on 'case-by-case' analysis of proposals and options; and most of the time, has rejected the proposal developed by the industry or the company.

The water situation in Arizona is going to become more difficult in the future, as is made clear in the "21st Century Vision" published by the Arizona Department of Water Resources. In order to provide for safe, adequate, and reliable water and wastewater service as we move forward into that future, we therefore adopt the Pennsylvania policies as our own.

¹ 1999 Water Task Force, Interim Report, Section II, Page 2, Item 1

² Arizona Regulatory Reports, "Time for Action – Regulatory Leadership Can Create a better Future", Pages 7-8

Attachment A is the policy we adopt for the acquisition and consolidation of small, nonviable water and wastewater systems; it is substantially identical to Pennsylvania's policy adopted in 052 Pa. Code § 69.711

Attachment B is the policy we adopt for the acquisition and consolidation of viable water and wastewater systems, of all sizes; it is substantially identical to Pennsylvania's policy adopted in 052 Pa. Code § 69.721

ORDER

IT IS THEREFORE ORDERED that the Commission adopts this substantive policy statement in accordance with A.R.S. § 41-1091.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall cause the attached policy statement to be posted on the Commission's website in accordance with A.R.S. § 41-1091.01 and that they cause the policy statement (or a summary thereof) to be published in the Arizona Administrative Register in accordance with A.R.S. §§ 41-1091(A) and 41-1013(B)(15).

SMALL NONVIABLE WATER AND WASTEWATER SYSTEMS— STATEMENT OF POLICY

Acquisition incentives.

(a) *General.* To accomplish the goal of increasing the number of mergers and acquisitions to foster regionalization, the Commission will consider the acquisition incentives in Section (b).

The following parameters shall first be met in order for Commission consideration of a utility's proposed acquisition incentive. It should be demonstrated that:

- (1) The acquisition serves the general public interest.
- (2) The acquiring utility meets the criteria of viability that will not be impaired by the acquisition; that it maintains the managerial, technical and financial capabilities to safely and adequately operate the acquired system, and is currently in compliance with all Arizona Department of Environmental Quality, Arizona Department of Water Resources, and Arizona Corporation Commission rules and orders; and will be able to meet other requisite regulatory requirements on a short and long-term basis.
- (3) The acquired system has less than 3,300 customer connections; the acquired system is not viable; it is in violation of statutory or regulatory standards concerning the safety, adequacy, efficiency or reasonableness of service and facilities; and that it has failed to comply, within a reasonable period of time, with any order of the Arizona Department of Environmental Quality or the Commission.
- (4) The acquired system's ratepayers should be provided with improved service in the future, with the necessary plant improvements being completed within a reasonable period of time.
- (5) The purchase price of the acquisition is fair and reasonable and the acquisition has been conducted through arm's length negotiations.

(6) The concept of single tariff pricing should be applied to the rates of the acquired system, to the extent that it is reasonable. Under certain circumstances of extreme differences in rates, or of affordability concerns, consideration should be given to a phase-in of the rate difference over a reasonable period of time.

(b) *Acquisition incentives.* In its efforts to foster acquisition of suitable water and wastewater systems by viable utilities when the acquisitions are in the public interest, the Commission seeks to assist these acquisitions by permitting the use of a number of regulatory incentives.

Accordingly, the Commission will consider the following acquisitions incentives:

(1) *Rate of return premiums.* Additional rate of return basis points may be awarded for certain acquisitions and for certain associated improvement costs, based on sufficient supporting data submitted by the acquiring utility within its rate case filing. The rate of return premium as an acquisition incentive may be the most straightforward and its use is encouraged.

(2) *Acquisition adjustment.* When the acquiring utility's acquisition cost differs from the depreciated original cost of the water or wastewater facilities first devoted to public use, the difference may be treated as follows for ratemaking purposes:

(i) *Credit acquisition adjustment.* When a utility pays less than the depreciated original cost of the acquired system, the acquiring utility may book and include in rate base the depreciated original cost of the acquired system, provided that the difference between the acquisition cost and depreciated original cost should be amortized as an addition to income over a reasonable period of time or be passed through to ratepayers by another methodology that is determined by the Commission. The acquiring utility may argue that no amortization or pass through is appropriate when the acquisition involves a matter of substantial public interest.

(ii) *Debit acquisition adjustment.* When a utility pays more than the depreciated original cost of the acquired system, the acquiring utility may book and include in rate base the excess of acquisition cost over depreciated original cost of the acquired system, provided that the utility can meet the requirements of Section (a), above. When the acquisition does not qualify under Section (a), the debit acquisition adjustment should be treated in accordance with generally accepted accounting principles and not be amortized for ratemaking purposes.

(3) *Deferral of acquisition improvement costs.* In cases when the plant improvements are of too great a magnitude to be absorbed by ratepayers at one time, rate recovery of the improvement costs may be recovered in phases. There may be a onetime treatment in the initial rate case of the improvement costs but a phasing-in of the acquisition, improvements and associated carrying-costs may be allowed over a finite period.

(4) *Plant improvement surcharge.* Collection of a different rate from customers of the acquired system upon completion of the acquisition could be implemented to temporarily offset extraordinary improvement costs. In cases when the improvement benefits only those customers who are newly acquired, the added costs may be allocated on a greater than average level--but less than 100%--to the new customers for a reasonable period of time, as determined by the Commission.

(c) *Procedural implementation.*

(1) An acquiring utility that has met the criteria set forth in Section (a), above, for inclusion of a debit acquisition adjustment in its rate base, may elect to have this acquisition adjustment considered on a case-by-case basis as set forth in Section (b), above, or as part of its next rate case filing. The acquiring utility should file the supporting documentation outlined in Section (d) to support the requested acquisition adjustment.

(2) The appropriate implementation procedure to qualify for the other acquisition incentives in Section (b) would be to file the appropriate supporting documentation during the next filed rate case.

(3) In acquisition incentive filings, the burden of proof rests with the acquiring utility.

(d) *Documentation to support inclusion of acquisition adjustment.* When an acquiring utility elects to have the acquisition adjustment to its rate base considered as a part of its next rate case filing, the acquiring utility should file the following documentation to support the acquisition adjustment to its rate base:

(1) *Statement of reliance on existing records.* An acquiring utility may elect to rely in whole or in part upon the original cost records of the seller or Commission in determining the original cost of the used and useful assets of the acquired system.

(2) *Preparation of data to support acquisition adjustment.* An acquiring utility, upon its own election, may file an original cost plant-in-service study with the Commission to support its requested acquisition adjustment to its rate base. An original cost study is one method of determining the valuation costs of the property of a public utility. It requires the acquiring utility to develop realistic plant balances and accumulates the records and accounting details that support those balances. Disputes regarding the acquiring utility's original cost valuation of the assets of the acquired system will be resolved in the context of a rate proceeding when interested parties will have an opportunity to be heard.

(i) *Contents of an original cost plant-in-service study.* When an acquiring utility elects to submit its own original cost of plant-in-service valuation, the acquiring utility is obligated to exercise due diligence and make reasonable attempts to obtain, from the seller, documents related to original cost. In particular, as part of its exercise of due diligence, the acquiring utility

should request from the seller, for purposes of determining the original cost plant-in-service valuation, the original cost of the assets being acquired and records relating to contributions in aid of construction (CIAC), such as the following:

(A) Accounting records and other relevant documentation and agreements of donations or contributions, services, or property from states, municipalities or other government agencies, individuals, and others for construction purposes.

(B) Records of unrefunded balances in customer advances for construction (CAC).

(C) Records of customer tap-in fees and hook-up fees.

(D) Prior original cost studies.

(E) Records of local, State and Federal grants used for construction of utility plant.

(F) Relevant Arizona Department of Environmental Quality records.

(G) Any Commission records.

(H) Summary of the depreciation schedules from all filed Federal tax returns.

(I) Other accounting records supporting plant-in-service.

(ii) *Failure of seller to provide cost-related documents.* The failure of a seller to provide cost-related documents, after reasonable attempts to obtain the data, will not be a basis for the Commission's denial of the inclusion of the value of the acquired system's assets in its proposed rate base. Because the documents obtained from the seller may be incomplete and may result in an inaccurate valuation, the acquiring utility will not be bound by the incomplete documents from the seller in the preparation of its original cost plant-in-service valuation.

(iii) *Procedure for booking CIAC.* The acquiring utility, at a minimum, should book as CIAC contributions that were properly recorded on the books of the system being acquired. If evidence supports other CIAC that was not booked by the seller, the acquiring utility should

make a documented effort to determine the actual CIAC and record the contributions for ratemaking purposes, such as lot sale agreements or capitalization vs. expense of plant-in-service on tax returns.

(iv) *Plant retired/not booked/not used and useful.* The acquiring utility should identify all plant retirements and plant no longer used and useful, and complete the appropriate accounting entries.

(v) *Reconciliation with commission records.* In the case of an acquisition of a water or wastewater system that is regulated by the Commission, the acquiring utility should reconcile and explain any discrepancies between the acquiring utility's original cost plant-in-service valuation and the Commission's records, to the extent reasonably known and available to the acquiring utility, at the same time the supporting documentation for the study is filed.

(e) *Time to submit original cost valuation.* When the acquiring utility elects to request an acquisition adjustment during its next rate filing, it should submit a copy of its newly prepared original cost plant-in-service valuation of the acquired system or a statement of reliance of the existing records of the Commission or the seller to the Commission's Utility Division at least 4 months prior to the date that the acquiring utility plans to make its next rate case filing with the Commission.

(1) The Commission staff may conduct an audit of the original cost valuation, but if no staff audit is completed and released at public meeting before the date of the rate case filing, the Commission's determination of the original cost valuation in the rate case will be deemed final action on the original cost valuation and any associated acquisition adjustment, absent subsequently discovered fraud or misrepresentation. When staff completes an audit before the rate case is filed, the results of the audit will not be binding on any party, but rather the audit

report will be made available to the public and the report can be presented in the acquiring utility's next rate case, subject to applicable evidentiary rules.

(2) When the acquiring utility makes a rate case filing sooner than the 4-month window, the acquiring utility should not include any revenues or expenses related to the acquisition, including the requested acquisition adjustment in its proposed rate base unless it includes the original cost valuation with the rate filing and one of the following circumstances applies:

(i) A compelling reason exists for requesting the acquisition adjustment in the current rate filing.

(ii) The acquisition was requested or otherwise directed by the Commission.

(iii) No statutory party objects to the inclusion of the acquisition adjustment to the proposed rate base of the acquiring utility.

(f) *Purchase price of the water and wastewater system.* The factors relevant to the reasonableness of the purchase price of the acquired water and wastewater system include:

(1) Promotion of long-term viability.

(2) Promotion of regionalization.

(3) Usage per customer.

(4) Growth rates.

(5) Cost of improvements.

(6) Age of the infrastructure.

(7) Return on equity.

(8) Existing rates.

(9) Purchase price per customer.

ACQUISITION PREMIUM POLICY STATEMENT

Option 1

The Arizona Corporation Commission ("Commission") has long recognized that consolidation of the many private water systems in Arizona is in the public interest and should be encouraged. To encourage this consolidation, it is the policy of the Commission that acquisition premiums should be allowed for acquisitions of private water systems subject to the following conditions:

1. The purchase price is fair and reasonable and conducted through arms' length negotiations;
2. If the acquirer is using single tariff pricing, that pricing should be applied to the acquired system;
3. The acquisition premium must be associated with improvements, which can be qualitative or quantitative or both; and
4. The premium must be reviewed and approved in a rate case.

It is the policy of the Commission that the acquisition premium be determined in accordance with the following principles (in addition to those above):

1. The revenue requirement for the acquiring company shall be adjusted to provide recovery of the approved premium;
2. The premium shall not exceed twenty percent of the original cost rate base;
3. The premium must be recovered over a defined period of time; and

4. Any adjustment to the revenue requirement will end when the premium is recovered or the defined period of time ends, whichever occurs first.

ACQUISITION PREMIUM POLICY STATEMENT

Option 2

The Arizona Corporation Commission ("Commission") has long recognized that consolidation of the many private water systems in Arizona is in the public interest and should be encouraged. To encourage this consolidation, it is the policy of the Commission that acquisition premiums should be allowed for acquisitions of private water systems subject to the following conditions:

1. The purchase price is fair and reasonable and conducted through arms' length negotiations;
2. If the acquirer is using single tariff pricing, that pricing should be applied to the acquired system;
3. The acquisition premium must be associated with improvements, which can be qualitative or quantitative or both; and
4. The premium must be reviewed and approved in a rate case.

It is the policy of the Commission that the acquisition premium be determined in accordance with the following principles (in addition to those above):

1. The premium shall not exceed twenty percent of the original cost rate base at the time of the acquisition.
2. One or more of the following may be used to provide recovery of the acquisition premium:
 - a. A premium on the return on equity

b. An acquisition adjustment (credit or debit adjustments to rate base for purchase price discounts or premiums, respectively, may be used).

i. *Credit acquisition adjustment.* If a utility pays less than the depreciated original cost of the acquired system adjusted for unrefunded advances and contributions net of amortizations, the acquiring utility may record and include in rate base the depreciated original cost adjusted for unrefunded advances and contributions net of amortizations of the acquired system. The difference between the acquisition cost and depreciated original cost should be amortized as an addition to income over a reasonable period of time or be passed through to ratepayers by another methodology that is determined by the Commission; unless the Commission determines that no amortization or pass through is appropriate because the acquisition involves a matter of substantial public interest.

ii. *Debit acquisition adjustment.* If a utility pays more than the depreciated original cost of the acquired system adjusted for unrefunded advances and contributions net of amortizations, the acquiring utility may record and include in rate base the excess of acquisition cost over depreciated original cost adjusted for unrefunded advances and contributions net of amortizations of the acquired system with an associated

amortization over a finite period of time to be determined in a subsequent rate case application.

- c. A deferral of acquisition improvement costs.
 - d. A surcharge for the recovery of acquisition improvement costs.
3. If the improvements that are required to improve service quality would result in rates that are deemed too high to be absorbed by ratepayers at one time, rate recovery of the improvement costs may be recovered in phases. There may be a one-time treatment of the improvement costs in the initial rate case but a phasing in of the acquisition improvements and associated carrying costs may be allowed over a finite period.

ACQUISITION PREMIUM POLICY STATEMENT

Option 3

The Arizona Corporation Commission ("Commission") has long recognized that consolidation of the many private water systems in Arizona is in the public interest and should be encouraged. To encourage this consolidation, it is the policy of the Commission that acquisition premiums should be allowed for acquisitions of private water systems subject to the following conditions:

1. The purchase price is fair and reasonable and conducted through arms' length negotiations;
2. If the acquirer is using single tariff pricing, that pricing should be applied to the acquired system;
3. The acquisition premium must be associated with improvements, which can be qualitative or quantitative or both; and
4. The premium must be reviewed and approved in a rate case.

It is the policy of the Commission that the acquisition premium be determined in accordance with the following principles (in addition to those above):

1. The total purchase price (as determined by an appraisal using the RCND method) shall be compared to the original cost rate base at the time of the acquisition to determine an acquisition premium in the next rate case.
2. The premium amount shall be amortized to expense over a specified time period.

ACQUISITIONS OF VIABLE WATER AND WASTEWATER SYSTEM— STATEMENT OF POLICY

Viable Water and wastewater system acquisitions.

- (a) *General.* The Commission believes that further consolidation of water and wastewater systems within this State may, with appropriate management, result in greater environmental and economic benefits to customers. The regionalization of water and wastewater systems through mergers and acquisitions will allow the water industry to institute better management practices and achieve greater economies of scale. To further this goal, the Commission sets forth the guidance in this section regarding the acquisition of water and wastewater systems. Guidance specifically applicable to the acquisition of nonviable systems is set forth in Attachment A to this policy (relating to acquisition incentives).
- (b) *Inclusion of acquisition assets in rate base.* After the approval of an acquisition, as evidenced by the receipt of a Commission decision approving the transfer of a certificate of convenience and necessity, an acquiring utility may request the inclusion of the value of the used and useful assets of the acquired system in its rate base. A request will be considered during the acquiring utility's next filed rate case proceeding.
- (c) *Method of valuation of acquisition assets.* The assets of the acquired system should be booked at the original cost of the acquired system when first devoted to the public service less the applicable accrued depreciation and related contributions.
- (d) *Determining original cost of acquisition assets.* An acquiring utility may use various methods to support its valuation of the original cost of the used and useful assets of the acquired water or wastewater system. For example, an acquiring utility may elect to rely in whole or in part upon the original cost records of the seller or the Commission in determining the original cost of the used and useful assets of the acquired system that are to be included in its rate base.
- (e) *Preparation of an original cost of plant-in-service valuation.* The Commission will not require an acquiring utility to submit a full original cost plant-in-service study in order to determine the value of the assets of the acquired system. An acquiring utility, upon its own election, may file an original cost study with the Commission to support its valuation of the assets of the acquired water and wastewater system proposed to be included in its rate base. A full original cost plant-in-service study is one method of determining the valuation costs of the property of a public utility. It requires the acquiring utility to develop realistic plant balances and accumulates the records and accounting details that support those balances. Disputes regarding the acquiring utility's original cost valuation of the acquired assets will be resolved in the context of a rate proceeding in which all interested parties will have an opportunity to be heard.
- (1) *Contents of an original cost plant-in-service study.* The acquiring utility is obligated to exercise due diligence and make reasonable attempts to obtain, from the seller, documents related to original cost. In particular, as part of its due diligence, the acquiring utility should request from the seller, for purposes of determining the original cost plant-in-service valuation,

the original cost of the assets being acquired and records relating to contributions in aid of construction (CIAC), such as the following:

(i) Accounting records and other related documentation and agreements of donations or contributions, services, or property from states, municipalities or other government agencies, individuals, and others for construction purposes.

(ii) Records of unrefunded balances in customer advances for construction (CAC).

(iii) Records of customer tap-in fees and hook-up fees.

(iv) Prior original cost studies.

(v) Records of local, State and Federal grants used for construction of utility plant.

(vi) Relevant Arizona Department of Environmental Quality records.

(vii) Any Commission records.

(viii) Summary of the depreciation schedules from all filed Federal tax returns.

(ix) Other accounting records supporting plant-in-service.

(2) *Failure of seller to provide cost-related documents.* The failure of a seller to provide cost-related documents, after reasonable attempts to obtain the data, will not be a basis for the Commission's denial of the inclusion of the value of the acquired system's assets in its proposed rate base. Because the documents obtained from the seller may be incomplete and may result in an inaccurate valuation, the acquiring utility will not be bound by the incomplete documents from the seller in the preparation of its original cost plant-in-service valuation.

(3) *Procedure for booking CIAC.* The acquiring utility, at a minimum, should book as CIAC contributions that were properly recorded on the books of the system being acquired. If evidence supports other CIAC that was not booked by the seller, the acquiring utility should make a documented effort to determine the actual CIAC and record the contributions for ratemaking purposes, such as lot sale agreements or capitalization versus expenses of plant-in-service on tax returns.

(4) *Plant retired/not booked/not used and useful.* The acquiring utility should identify all plant retirements and plant no longer used and useful and complete the appropriate accounting entries.

(5) *Reconciliation with commission records.* In the case of an acquisition of a water or wastewater system that is regulated by the Commission, the acquiring utility should reconcile and explain any discrepancies between the acquiring utility's original cost plant-in-service valuation and the Commission's records, to the extent reasonably known and available to the acquiring utility, at the same time the supporting documentation for the study is filed.

(f) *Time to submit original cost valuation.* When the acquiring utility elects to request inclusion of its acquisition in its rate base, it should submit a copy of its newly prepared original cost plant-in-service valuation of the acquired system or a statement of reliance of the existing records of the Commission or the seller to the Commission's Utility Division at least 4 months prior to the date that the acquiring utility plans to make its next rate case filing with the Commission.

(1) The Commission staff may conduct an audit of the original cost valuation, but if no staff audit is completed and released at public meeting before the date of the rate case filing, the Commission's determination of the original cost valuation in the rate case will be deemed final action on the original cost valuation, absent subsequently discovered fraud or misrepresentation. When staff completes an audit before the rate case is filed, the results of the audit will not be binding on any party, but rather the audit report will be made available to the public and the report can be presented in the acquiring utility's next rate case, subject to applicable evidentiary rules.

(2) When the acquiring utility makes a rate case filing sooner than the 4-month window, the acquiring utility should not include any revenues or expenses related to the acquisition, including the requested acquisition adjustment in its proposed rate base unless it includes the original cost valuation with the rate filing and one of the following circumstances applies:

- (i) A compelling reason exists for requesting the acquisition in the current rate filing.
- (ii) The acquisition was requested or otherwise directed by the Commission.
- (iii) No statutory party objects to the inclusion of the acquisition to the proposed rate base of the acquiring utility.

(g) *Acquisition incentives.* In its efforts to foster the acquisitions of smaller, less viable water and wastewater systems by larger more viable systems, the Commission has broad latitude to allow the acquiring utility to request a rate of return premium in a subsequent rate case. The allowance of a rate of return premium, as an acquisition incentive for an acquisition that falls outside of the parameters of Attachment A to this policy (relating to acquisition of nonviable water and wastewater utilities), may be requested by those utilities that have a demonstrated track record of acquiring and improving the service provided to the customers of smaller and less viable water systems. The allowance of additional rate of return basis points may be awarded based on sufficient supporting data submitted by the utility within its rate case filing.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE – Chairman

BOB STUMP

BOB BURNS

TOM FORESE

ANDY TOBIN

Arizona Corporation Commission)
Investigation into Potential Improvements)
to its Water Policies)

Docket No. W-00000C-16-0151

Arizona Corporation Commission

Policy Statement on Regional Consolidation

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under § 41-1033, Arizona Revised Statutes, for a review of the statement.

Currently, the Arizona Corporation Commission regulates over 280 water utilities, many of which are small or very small. Many of these small water companies are distressed utility companies. As Commission Staff has stated in prior dockets, water companies with 500 or fewer customers may be distressed. As a result, the Commission has often been forced to decide difficult dockets involving customer complaints,

regulatory compliance, finances and rates relating to small, distressed water utilities in Arizona, sometimes under emergency circumstances. Therefore, as a matter of policy, the Commission believes that it is in the public interest to encourage the acquisition and consolidation of smaller distressed water utilities in Arizona by larger, more financially secure and operationally stable utilities.

We recognize that utilities may approach rate consolidation in such instances in different ways: Some may propose rate consolidation for systems that are operated by the same staff; Some may propose rate consolidation for systems that are geographically close and thus face similar challenges; Others may propose larger rate consolidation approaches. The Commission is not ordering a "one size fits all" solution to the rate consolidation question. We are, however, establishing a policy to provide guidelines for all interested parties.

To achieve the goal of incenting the consolidation of the water industry, the Commission adopts this policy of "Regional Consolidation."

Regional Consolidation in this context refers to the acquisition of smaller distressed water systems by larger, financially secure and operationally stable utility providers, followed by consolidation of the smaller systems into the larger system.

Generally, the smaller distressed water systems may be challenged due to lack of capital, inadequate rates and revenues, regulatory non-compliance, day-to-day operational deficiencies and/or inadequate management and supervision. In such circumstances, there is likely to be little intrinsic incentive for the larger utility to acquire the smaller system because the smaller system usually has little

to no fair value rate base, and the potential acquirer will be faced with significant capital and operational expenditures with limited ability to recover those costs in rates.

Under these circumstances, the Commission should incentivize Regional Consolidation through a combination of streamlined regulatory proceedings, cost recovery mechanisms, ratemaking improvements and acquisition adjustments.

This new policy will be applied in all future proceedings, including approvals of acquisitions, ratemaking dockets or any other dockets where the acquisition and consolidation of a smaller, financially and/or operationally distressed water utility by a larger utility is at issue. We desire this policy to be applied to guide such proceedings, in a fair and balanced manner, towards a conclusion wherein Regional Consolidation will minimize or eliminate the distress being suffered by the acquired entity's customers.

ORDER

IT IS THEREFORE ORDERED that the Commission adopts this substantive policy statement in accordance with A.R.S. § 41-1091.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall cause the attached policy statement to be posted on the Commission's website in accordance with A.R.S. § 41-1091.01 and that they cause the policy statement (or a summary thereof) to be published in the Arizona Administrative Register in accordance with A.R.S. §§ 41-1091(A) and 41-1013(B)(15).

Accordingly, the Regional Consolidation Policy shall be as follows:

Option 1

1. The Commission will seek to expedite necessary approvals, including rate relief as necessary, to facilitate the acquisition of distressed water systems by larger utilities.
2. In the first full general rate case following any such acquisition, the Commission will consider rate consolidation, as well as the use of acquisition adjustments, rate of return premiums, reconstruction cost, accounting orders and other available ratemaking measures in order to recognize in rates the added value resulting from the larger utility's acquisition of the smaller distressed system. Rate consolidation, or "single tariff pricing" is encouraged in a Regional Consolidation situation, although we do recognize that in some circumstances, because of significant rate disparities, phase-ins and gradual transitions may be warranted.
3. The Commission directs Commission Staff to evaluate and consider all of these and other ratemaking options and to initiate a rulemaking to adopt rules to implement this policy.

Option 2

1. The Commission will expedite necessary approvals, including rate relief as necessary, to facilitate the acquisition of distressed water systems.
2. At the time of providing any necessary approvals for the acquisition of a smaller, distressed water utility by a larger water utility, the Commission shall also approve an acquisition adjustment, rate of return premium or other available ratemaking measure that provides the acquiring utility assurance that the rates charged to its customers will recognize the added value resulting from the larger utility's acquisition of the smaller distressed system. Rate consolidation, or "single tariff pricing" is encouraged, although we do recognize that in some circumstances, because of significant rate disparities, phase-ins and gradual transitions may be warranted.
3. Thereafter, in the first full general rate case following any such acquisition, the Commission will approve rate consolidation, and shall approve rates that include the acquisition adjustment, rate of return premium or other available ratemaking measure previously approved to ensure that the acquiring utility's rates recognize the added value resulting from the larger utility's acquisition of the smaller distressed system.
4. The Commission directs Commission Staff to evaluate and consider all of these and other ratemaking options and to initiate a rulemaking to adopt rules to implement this policy.

Option 3

1. The Commission will expedite necessary approvals, including rate relief as necessary, to facilitate the acquisition of distressed water systems.
2. At the time of providing any necessary approvals for the acquisition of a smaller, distressed water utility by a larger water utility, the Commission shall also approve an acquisition adjustment equal to the difference between original cost less depreciation rate base and reconstruction cost new less depreciation rate base, without adjustment for inflation, along with any needed accounting orders or other necessary ratemaking measures in order to determine a fair value rate base that clearly recognizes the added value resulting from the larger utility's acquisition of the smaller distressed water system. Rate consolidation, or "single tariff pricing" is encouraged, although we do recognize that in some circumstances, because of significant rate disparities, phase-ins and gradual transitions may be warranted.
3. Thereafter, in the first full general rate case following any such acquisition, the Commission will approve rate consolidation, and shall approve rates that implement the approved acquisition adjustment. At the same time, the Commission shall consider whether a rate of return premium or other available ratemaking measure is necessary to further ensure that the acquiring utility's rates recognize the added value resulting from the larger utility's acquisition of the smaller distressed system.

4. The Commission directs Commission Staff to evaluate and consider all of these and other ratemaking options and to initiate a rulemaking to adopt rules to implement this policy.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

DOUG LITTLE – Chairman

BOB STUMP

BOB BURNS

TOM FORESE

ANDY TOBIN

Arizona Corporation Commission)
Investigation into Potential Improvements)
to its Water Policies)

Docket No. W-00000C-16-0151

Arizona Corporation Commission

Policy Statement on Water Utility Acquisition Processes

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under § 41-1033, Arizona Revised Statutes, for a review of the statement.

Arizona's water utility industry remains highly fragmented. We acknowledge the hard work and dedication of many operators of small water utility systems. However, such systems lack economies of scale, and often they also have difficulties accessing equity and debt capital, and some lack the management and technical expertise that a larger enterprise can offer. The

Commission has faced—time and time again—urgent problems posed by some small water utilities who become unable to meet their public service responsibilities. Thus, the Commission encourages consolidation in the water and wastewater industry. Beneficial consolidation includes both acquisitions by large utilities with extensive financial, technical and managerial capabilities, as well as smaller utilities merging together to realize increased capabilities and economies of scale.

Unfortunately, the process for Commission approval of acquisitions has often been too lengthy and burdensome. We do not want the process itself to stand as a deterrent or disincentive to pursuing consolidation. Accordingly, we adopt the attached policy statement to streamline and accelerate the process for Commission approval of acquisitions.

ORDER

IT IS THEREFORE ORDERED that the Commission adopts this substantive policy statement in accordance with A.R.S. § 41-1091.

IT IS FURTHER ORDERED that the Commission Utilities Division and Legal Division shall cause the attached policy statement to be posted on the Commission's website in accordance with A.R.S. § 41-1091.01 and that they cause the policy statement (or a summary thereof) to be published in the Arizona Administrative Register in accordance with A.R.S. §§ 41-1091(A) and 41-1013(B)(15).

Policy Statement on Water Utility Acquisition Process

1. For sales of water or wastewater utility systems and/or transfers of certificates of convenience and necessity which require Commission approval, where the acquiring entity is a water or wastewater utility in good standing with the Commission and has more customers than the selling utility, the following procedures will apply:

OPTION ONE

Absent extraordinary circumstances, when a Class A water or wastewater utility requests a waiver under A.A.C. R14-2-806 for such a transaction, the Commission will allow the waiver to take effect by operation of law under A.A.C. R14-2-806(C). The waiver application must comply with A.A.C. R14-2-806(B) but need not include the information specified in A.A.C. R14-2-803(A).

OPTION TWO

[Can be combined with Option One]

We direct the Commission staff to commence a rulemaking to consider the following amendment to A.A.C. R14-2-803: "D. A notice of intent under this section is not required when the reorganization of an existing Arizona water or wastewater public utility holding company is due to the purchase of the shares (or merger of) a Class C, D, or E water or wastewater utility".

OPTION THREE

We hereby grant a waiver under A.A.C. R14-2-806 to each Class A water or wastewater utility for all such transactions.